

VALUATION MANUAL

September 2007
Proposed Draft

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I. INTRODUCTION

AUTHORITY and APPLICABILITY

The Valuation Manual sets forth the minimum reserve and related requirements pursuant to the Standard Valuation Law. The reserve requirements in this Valuation Manual satisfy the minimum valuation requirements of the Standard Valuation Law. The requirements in the Valuation Manual are the requirements of the state for purposes of minimum reserves and related requirements under the Standard Valuation Law.

Requirements in the Valuation Manual are applicable to all life, annuity, deposit-type contracts and health insurance business as provided in the Valuation Manual.

BACKGROUND

As insurance products have increased in their complexity, and as companies have developed new and innovative product designs that change their risk profile, the need to develop new valuation methodologies or revisions to existing requirements to address these changes has led to the development of the Valuation Manual. The need has also arisen to develop a valuation standard that enhances uniformity among the principles-based valuation requirements across states and insurance departments. Finally, it defines a process to facilitate future changes in valuation requirements on a more timely and efficient basis.

The goals of the National Association of Insurance Commissioners (NAIC) in developing this Valuation Manual are:

1. To consolidate into one document the minimum reserve requirements for life, annuity and health products pursuant to the NAIC Standard Valuation Law (SVL), including those products subject to principles-based valuation requirements and those not subject to principles-based valuation requirements.
2. To promote uniformity among states' valuation requirements.
3. To provide for an efficient, consistent, and timely process to update valuation requirements as the need arises.
4. To mandate and facilitate the specific reporting requirements of experience data.
5. To specify the content and format of an annual independent actuarial review.
6. To enhance industry compliance with the MM/DD/200X revisions to the SVL, as adopted in various states.

DESCRIPTION OF MANUAL

This Valuation Manual (“Manual”) contains the minimum reserve standards for all life, health, and deposit-type contracts subject to the NAIC Model Standard Valuation Law (SVL) reproduced in VM-5 of this Manual and pursuant to the adoption of the same or similar requirements by the adopting state.

The Valuation Manual contains six sections:

The first section is an introductory section that includes the general concepts underlying the reserve requirements in this Manual.

The second section summarizes the reserve standards which apply to a product or type of product including which products or categories of products are subject to principles-based valuation standards and reporting and independent review requirements. As reserve standards are developed for various products or categories of products, those standards will be incorporated into this section. The applicability of the reserve standards to particular products will be clarified in the appropriate subsection. For example, the reserve standards that apply to a life insurance product will be identified in the subsection addressing life insurance reserve requirements.

The third section sets forth the reporting requirements which include actuarial opinion and memorandum requirements and principles-based reporting requirements.

The fourth section sets forth the requirements relating to the annual independent review.

The fifth section sets forth the experience reporting requirements.

The sixth section contains Valuation Manual Minimum Standards. These standards contain the specific requirements that are referenced in Sections II - V.

OPERATIVE DATE OF VALUATION MANUAL

The requirements in this manual become operative on January 1 following the date that:

1. the valuation manual or a change to the valuation manual is adopted by at least seventy-five percent (75%) of the NAIC Executive and Plenary members; and
2. at least 39 states have adopted changes to the Standard Valuation Law which enable such states to follow the requirements of this Valuation Manual without further adoption of law and such states have adopted any necessary regulations or other requirements in order to follow the requirements in the Valuation Manual.

PROCESS FOR UPDATING MANUAL

The Life & Health Actuarial Task Force (LHATF) is responsible for developing changes to the Valuation Manual for NAIC adoption. Any changes must conform to guidelines developed by the NAIC to support joint use of reserve and other requirements as appropriate by both the Accounting Practices and Procedures Manual and the Valuation Manual. Such guidelines will require the development of an issues paper to be submitted to the Statutory Accounting Principles Working Group (SAPWG) for their review and input on the proposed Valuation Manual changes. This issues paper will also include an analysis of the impact of these changes on reserves, the consumer, and the industry including any different impact based on size of company.

The SAPWG must approve the Valuation Manual changes as being in conformance with these guidelines and LHATF must approve the Valuation Manual changes. The Valuation Manual changes must then be adopted by the A, or B (as applicable), and E Committees prior to NAIC adoption by Executive and Plenary. The actual NAIC process may need to be developed and documented outside the Valuation Manual.

Drafting Note: This process is ultimately the responsibility of the NAIC where the draft above is intended to provide a placeholder and possible initial considerations.

OVERVIEW OF RESERVE CONCEPTS

Reserve requirements prescribed in this manual are intended to be consistent with the Objectives of Statutory Financial Reporting as set forth in the Preamble to the Accounting Practices and Procedures Manual in the Statutory Accounting Principles Statement of Concepts. Any ambiguity or inconsistency in a requirement set forth in this manual should be addressed in a manner consistent with those objectives.

To the extent that reserve requirements specified in the Manual are substantially the same as the requirements specified in NAIC Models laws, regulations and guidelines on the operative date of the Manual, a company shall maintain the methods, assumptions, levels of conservatism, approved or deemed acceptable by state commissioners on the valuation date immediately prior to the operative date of the Manual.

A principles-based valuation is a reserve valuation that uses one or more methods or one or more assumptions determined by the insurer and as required by the Manual. This is in contrast to valuation approaches that use only prescribed assumptions and methods. Although a reserve valuation may meet the definition of a principles-based valuation because one or more method or assumption is determined by the insurer, such valuation is only subject to the principles-based valuation requirements as provided in the SVL, Section 11 (h), found in VM-5 of this Manual, if specified in this Manual for the product or category of products.

DRAFT FOR DISCUSSION PURPOSES. Is the manual the appropriate place for these concepts?

Such principles-based valuation requirements are deemed consistent with the following concepts:

1. Captures the benefits and guarantees associated with the contracts and their identifiable, quantifiable and material risks, including the ‘tail risk’ associated with each product and the funding of the risks.
2. Utilizes risk analysis and risk management techniques to quantify the risks and is guided by the evolving practice and expanding knowledge in the measurement and management of risk. This may include, to the extent required by an appropriate assessment of the underlying risks, stochastic models or other means of analysis that properly reflect the risks of the underlying contracts.
3. Incorporates assumptions, risk analysis methods and models and management techniques that are consistent with, those utilized within the company’s overall risk assessment process. The inclusion of the risk analysis methods and models should consider the original purpose of that analysis. Risk and risk factors explicitly or implicitly included in the company’s risk assessment and evaluation processes will be included in the risk analysis and cash flow models used in the principles-based valuation. Examples of company risk assessment processes may include economic valuations, internal capital allocation models, experience analysis, asset adequacy testing, GAAP valuation and pricing.
4. Utilizes company experience, based on the availability of relevant company data and its degree of credibility, to establish assumptions for risks over which the company has some degree of control or influence.
5. Incorporates assumptions that, when viewed in the aggregate, reflect an appropriate level of conservatism and, together with the methods utilized, recognize the solvency objective of statutory reporting.

6. Reflects risks and risk factors in the calculation of the principles-based valuation minimum statutory reserves and statutory RBC that may be different from one another and may change over time as products and risk measurement techniques evolve, both in a general sense and within the company's risk management processes.

II. RESERVE REQUIREMENTS

This section describes the reserve requirements by product or type of product. All reserves must be developed in a manner consistent with the requirements and concepts stated in the Overview of Reserve Concepts in Section I of this Manual.

LIFE

Scope:

1. This section establishes reserve requirements for all contracts classified as life contracts defined in VM-2 of this Manual.
2. Minimum reserve requirements for business in force on the operative date of the Manual are the applicable state requirements as of that date.
3. Minimum reserve requirements for life contracts specified in VM-3 as subject to principles-based reserve valuations which are issued on or after the operative date of the Valuation Manual are subject to reserve requirements in VM-20.
4. Minimum reserve requirements for life contracts specified in VM-3 that are not subject to principles-based reserve valuations which are issued on or after the operative date of the Valuation Manual will follow reserve requirements for such contracts as provided in the Accounting Practices and Procedures Manual as of the operative date of this Manual. An exception to this is Credit Life whose reserve requirements are set forth in this section. *(Drafting Note: If these requirements, other than Credit Life, are drafted directly into the Valuation Manual then the reference will be changed to the appropriate section of the Valuation Manual.)*

ANNUITY

Scope:

1. This section establishes reserve requirements for all contracts classified as annuity contracts defined in VM-2 of this Manual.
2. Minimum reserve requirements for business in force on the operative date of the Manual are the applicable state requirements as of that date with the exception of variable annuity contracts in paragraph 3 below.
3. Variable annuity contracts specified in VM-3 as subject to principles-based reserve valuations, for all dates of issue must comply with the reserve requirements in VM-21.
4. Minimum reserve requirements for fixed annuity contracts specified in VM-2 as subject to principles-based reserve valuations which are issued on or after the operative date of the Valuation Manual must comply with the reserve requirements in VM-22.
5. Minimum reserve requirements for fixed annuity contracts specified in VM-2 that are not subject to principles-based reserve valuations which are issued on or after the operative date of the Valuation Manual will follow reserve requirements for such contracts as provided in the Accounting Practices and Procedures Manual as of the operative date of this Manual. *(Drafting Note: If these requirements are*

drafted directly into the Valuation Manual then the reference will be changed to the appropriate section of the Valuation Manual.)

DEPOSIT-TYPE CONTRACTS

Scope:

1. This section establishes reserve requirements for all contracts classified as deposit-type contracts defined in VM-2 of this Manual.
2. Minimum reserve requirements for business in force on the operative date of the Manual are the applicable state requirements as of that date.
3. Minimum reserve requirements for business issued on or after the operative date of the Valuation Manual will be those as provided in the Accounting Practices and Procedures Manual as of the operative date of this Manual. *(Drafting Note: If these requirements are drafted directly into the Valuation Manual then the reference will be changed to the appropriate section of the Valuation Manual.)*

HEALTH

1. This section establishes reserve requirements for all contracts classified as health contracts defined in VM-2 of this Manual.
2. Minimum reserve requirements for business in force on the operative date of the Manual are the applicable state requirements as of that date.
3. Minimum reserve requirements for business issued on or after the operative date of the Valuation Manual are provided in VM-25. An exception to this is Credit Disability whose reserve requirements are provided in VM-26.

CREDIT LIFE & DISABILITY

This section establishes reserve requirements for all contracts classified as credit life and credit disability contracts in VM-2 of this Manual.

1. Minimum reserve requirements for business in force on the operative date of the Manual are the applicable state requirements as of that date.
2. Minimum reserve requirements for credit life and credit disability contracts issued on or after the operative date of the Valuation Manual are provided in VM-26.

RIDERS AND SUPPLEMENTAL BENEFITS

1. If a rider or supplemental benefit to one of the above types of products has a separate premium, then the following apply:
 - a. If the premium is not paid through a reduction in any value (such as account value) of the base policy, the minimum reserve standard for the rider or supplemental benefit is the minimum reserve standard for the above product or type of product with the most comparable risks and benefits. For example, the minimum reserve standard for a long term care

rider to a universal life policy is the minimum reserve standard for long term care in VM-25;

- b. If the premium is paid through a reduction in any value (such as account value) of the base policy, all cash flows associated with the rider or supplemental benefit must be included in the calculation of the reserve for the base policy. A separate reserve is not determined for the rider or supplemental benefit.
2. If a rider or supplemental benefit does not have a separate premium, all cash flows associated with the rider or supplemental benefit must be included in the calculation of the reserve for the base policy. For example, reserves for a universal life policy with an accelerated benefit for long term care must include cash flows from the long term care policy in determining minimum reserves in compliance with VM-20. A separate reserve is not determined for the rider or supplemental benefit.

CLAIM RESERVES

Regardless of the requirement for use of the PBR approach to policy reserves, the claim reserves, including waiver of premium claims, are not subject to PBR requirements of this Manual.

III. REPORTING REQUIREMENTS

Reporting requirements regarding the annual actuarial opinion and memorandum requirements pursuant to Section 3 of the NAIC Model Standard Valuation Law (VM-5) are provided in VM-30.

Reporting requirements applicable to products or types of products subject to Principles-based Reserve Valuations as specified in VM-3 are provided in VM-31.

IV. ANNUAL PRINCIPLES-BASED REVIEW REQUIREMENTS

Annual Principles-Based Review requirements applicable to products or types of products subject to Principles-Based Reserve requirements as specified in VM-3 are found in VM-40.

V. EXPERIENCE REPORTING REQUIREMENTS

Experience reporting requirements are provided in VM-50. The associated experience reporting formats and additional instructions are provided in VM-51.

Drafting Note: The scope of experience reporting requirements is still under development. Further LHATF input will be sought.

VI. Valuation Manual Minimum Standards

This section provides the specific minimum reserve standards as referenced by the preceding sections.